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IN THE

Supreme Court of the United States

OCTOBER TERM, 1955.

No. 378.

THE FIRST NATIONAL BANK,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

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The present case involves no "lifting of the bar of the statute of limitations". This is a misplaced metaphor. No refund is claimed for 1937 and no deficiencies are involved for that year. The only question is how to compute a recovery exclusion for the year 1949 which is not barred by any statute of limitations.

Respondent in his brief says there is no conflict between the decision below and this Court's decisions in *Lewis* v. *Reynolds,* 284 U. S. 281, *Bull* v. *U. S.,* 295 U. S. 274, and the opinion of the Court of Appeals for the Second Circuit in *Commissioner* v. *Van Bergh,* 209 F. 2d 23, because in the cited cases only one taxable year was involved or there was only a single taxable event. In the present case, however, there is also only one year involved, and that year is an open year, 1949. The only taxable event involved

is the recovery in 1949. On the recovery in 1949 of a bad debt written off and deducted in 1937, petitioner is entitled to exclude from taxable income, as a return of principal, that part of the recovery from which he derived no tax benefit. Obviously one must look to 1937. The only question is whether to look to the true facts for that year or only to the return as filed for the year.

Mathey v. *Commissioner*, 177 F. 2d 259, 264 (CA 1), cited by respondent, at most only holds that no recovery exclusion is available where the bad debt recovered was not deducted and allowed. The Court said:

> "And the taxpayer has wholly failed to show that he took any tax deduction for the years prior to 1944 on account of United's infringement, to say nothing of showing that such a deduction resulted in no tax benefit to him."

If anything, this would indicate that the taxpayer does have the right to show that a bad debt deduction previously taken resulted in no tax benefit to him. In the present case the only tax benefit petitioner could have had is a hypothetical one. There is nothing hypothetical, however, about the tax petitioner has paid just to recover part of a sum it loaned. It is submitted that in the absence of any real tax benefit such a taxation of the return of capital is beyond the powers granted Congress by the Sixteenth Amendment to the Federal Constitution. The effect of the decision below is to interpret the statute involved in a manner which renders it unconstitutional.

Respondent's footnote at page 8 overlooks the point made in our petition for rehearing below that the Commissioner is taking an inconsistent position in this very same matter in 1944 and 1945 with respect to the 1941 loss. Claims for refund filed by the taxpayer for 1944 and 1945,

based on recovery exclusions for those years, on account of the 1941 loss as reported in the 1941 tax return, have been denied, the Commissioner readjusting the loss in the return on the basis of the true facts even though the statute of limitations has run on 1941. This is but another example of the confusion which now exists and will continue to exist if the decision below in this case is permitted to stand.

The respondent does not deny or attempt to refute the public importance of the instant case in the administration of the Federal tax laws. Nor does the respondent deny that the decision below presents an important and continuing question of statutory interpretation. Moreover, in attempting to distinguish *Lewis* v. *Reynolds, Bull* v. *U. S.* and *Commissioner* v. *Van Bergh, supra,* respondent's brief only points up the conflict between those cases and the decision below. Respondent's argument in his brief does not set forth any valid reason why the case is not one of the type which this Court should review.

If the decision below stands, the case will have to be distinguished continually, leaving taxpayers, courts and the Commissioner equally confused. The law will be one way with respect to refund or deficiency assessment net recoveries and another way with respect to bad debt recoveries. There are numerous cases to the effect that when the Commissioner asserts a deficiency against a taxpayer, the taxpayer may, even after the year is barred by the statute of limitations for claiming refunds, claim offsetting adjustments in that year. *Barry* v. *Commissioner,* 1 B. T. A. 156 (1924), acq. IV-2 C. B. 1; *Gutterman Strauss Co.* v. *Commissioner,* 1 B. T. A. 243 (1924), acq. V-1 C. B. 1; *Kling* v. *Commissioner,* 1 B. T. A. 1048 (1924), acq. IV-2 C. B. 1; *Hickory Spinning Co.* v. *Commissioner,* 1 B. T. A. 409 (1924), acq. IV-2 C. B. 1; *Hyams Coal Co.* v. *Commissioner,* 1 B. T. A. 217 (1924), acq. IV-1 C. B. 2;

Howard Sheep Co. v. *Commissioner,* 1 B. T. A. 966 (1924); *Columbia Textile Co., Inc.* v. *Commissioner,* 2 B. T. A. 472 (1925); *Auerbach* v. *Commissioner,* 2 B. T. A. 67 (1925), acq. IV-2 C. B. 1; *Jackman* v. *Commissioner,* 2 B. T. A. 515 (1925); *Metzger* v. *Commissioner,* 5 B. T. A. 1230 (1926), acq. VI-2 C. B. 5; *Frischkorn* v. *Commissioner,* 7 B. T. A. 431 (1927), acq. VII-1 C. B. 11.

Our assertion that Congress specifically made an exception to the statute of limitations by enacting Section 22(b)(12) has foundation. The facts occurring in the prior year, even though that year may be barred by limitations, are made determinative of the taxability of the recovery in the year in which it occurs. See *Helvering* v. *State Planters Bank & Trust Co.,* 130 F. 2d 44 (4th Cir. 1942).

We sincerely believe that certiorari should be granted to resolve the existing conflict between the decision below and the applicable decisions of this Court, to determine an important question of statutory construction and to arrive at a fair and equitable rule for the guidance of taxpayers, courts and the Commissioner in recovery exclusion cases.

Dated: October 25, 1955.

Respectfully submitted,

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